TAXATION – ALTERNATIVE MINIMUM TAX

Information Update

DATE: January, 2001

Implemented in 1986, **Alternative Minimum Tax (AMT)** was introduced to address concerns that some individuals and trusts with high gross incomes paid little or no income tax. *It arises in agriculture tax situations when a combination of income and non-taxable capital gains exceeds $40,000. A flat tax rate then comes into effect, which is presently set at 17%. Due to this measure, farmers looking at retiring with potential capital gains may be affected by the resulting tax consequences.*

During the 2000 year, there have been changes to the Capital Gains inclusion rate as Federal Budget changes occurred on February 27, 2000 and October 18, 2000. The Capital Gains inclusion rate chronology was as follows:

***Prior to February 27,2000** – 75%*
***Between February 27, 2000 and October 17,2000** – 66 2/3%*
***On or after October 18, 2000** – 50%*

Because the Capital Gains inclusion rates have decreased, the effect on the Alternative Minimum Tax has been to increase the potential tax payable by the taxpayer (i.e. from 25 % to 50%). Whether this will be amended in a future federal budget to reflect the general intent of reducing taxes, as was done with Capital Gains, remains to be seen. ***For further information on Capital Gains refer to Information Update: Taxation – Capital Gains and Losses.***

Tax legislation continues to change and the information contained in this Information Update is based on the prevailing tax legislation information at the date of publication.

If you have a tax situation that might involve triggering the Alternative Minimum Tax, it is strongly recommended that professional taxation and legal advice be obtained to manage the potential taxation liability that might occur.

This Information Update will illustrate how **AMT** can affect the estate plans of farmers.

WHEN DOES ALTERNATIVE MINIMUM TAX ARISE

Farmers will most likely pay **AMT** when **potential taxable capital gains** are reported. You may also be liable to pay **AMT** if one of the following situations arises:

- reported **taxable dividends**
- claimed any of the following tax credits:
  - **Investment tax credit**
  - **Federal political contribution tax credit**

  - **Overseas employment tax credit**
  - **Labor sponsored funds tax credit**
- reported a **taxable capital gain (as mentioned above)**
- reported one of the following:
  - a loss resulting from, or increased by, claiming **capital cost allowance (CCA)**
    - Multiple-unit residential buildings
    - Certified films and videotapes (your share of partnership loss is included)
  - a loss resulting from, or increased by, claiming resource expenses that exceeds income from resource properties.
  - a deduction on the transfer of retiring allowances or regular pension receipts to a registered retirement savings plan or registered pension plan.
  - employee stock option plan deduction and other deductions.
  - employee home relocation loan deduction.

Exceptions for Certain Returns

- Special returns of incomes filed on behalf of bankrupt or deceased taxpayers.
- An ordinary return of an individual who died in a year.
- Partnerships are not subject to AMT, but individually the partners may be liable, depending on the circumstances.

ALTERNATIVE MINIMUM TAX (AMT) – A Four Step Process

Step One: Have a Taxable Income based on the standard **T1 General** tax return.

Step Two: Use **Form T691** to take the Taxable Income figure from Step One and calculate an Adjusted Taxable Income figure. A general exemption of $40,000 is then provided, which is used to reduce the potential tax liability for the low to middle income tax bracket earners.

Step Three: Multiply the result of Step Two by a flat federal tax of 17%. Total Non-Refundable Tax Credits are deducted from this figure to arrive at **the AMT amount payable**.

Step Four: Compare the Federal Tax payable under your T1 to the final calculation in Step Three. Whichever is the higher calculated figure is what the individual will pay.

In the circumstance that **the AMT calculation does exceed the regular Federal Tax, this excess amount can be carried forward to reduce regular federal tax payable for seven years.** So for a farmer that incurs an AMT payable liability in a year of selling assets, this amount could be recovered in subsequent years of "normal" income.

A BASIC EXAMPLE OF THE AMT CALCULATION . . .

This example highlights the basic mechanics of how the AMT calculation works for the 2000 tax year.

A farmer sells farmland in November 2000 at $650,000. This land has a cost base of $250,000, resulting in a potential capital gain of $400,000. Since the farmer has a lifetime Capital Gains exemption of $500,000, regular taxable income reported on the **T1 General** form is not affected. The Net Income from Farming Activities for 2000 is $35,000 as reported on **Form 2042**.

The spouse in this case has independent income. Using the **T1 General** form with the Net Income figure provided, the farmer's personal exemption plus the exemption allowed for CPP contribution totals $9,638. A Non-Refundable Tax Credit of $1,638 is obtained by multiplying this figure by 17%.

In addition, the farmer in this example was also able to make an RRSP contribution of $7,000.

Using **Form T691** on the above example

Step One:

- the **T1 General** income reported is $28,000 ($35,000 - $7,000 RRSP).		+ $28,000

Step Two:

- On Line 6780 of the **T691**, the RRSP contribution is added back.		+ 7,000
- The capital gain of $400,000 multiplied by 50% represents the portion of capital gains that are normally not taxable. This calculation is performed irrespective of the use or not of the $500,000 Capital Gains Exemption.		+ $200,000
- The total of these three figures is the Adjusted Taxable Income for Minimum Tax.	**Total**	$235,000
- The General exemption of $40,000 is subtracted.	**Less**	- $40,000
- The resulting figure is Net Adjusted Taxable Income.		$195,000

Step Three:

- This figure is multiplied by 17% to yield the Gross Minimum Amount Payable.	$33,150
- Less, in this example, the Total Non-Refundable Tax Credit as mentioned in the case description.	- $1,638
Minimum Amount	$31,512

Step Four:

Basic Federal Tax is $3,122, as calculated in this example. What the individual will pay is the **largest amount of** the Basic Federal Tax or the Minimum Tax. **In this case, as calculated in Step Three, the Minimum Amount of $31,512 will be paid in 2000**.

Remaining Taxes to be calculated are the Basic Manitoba Income Tax, Manitoba Net Income Tax, Federal Surtax (which now uses the higher AMT figure), and Manitoba Surtax[1].

It is important to remember that the Manitoba Tax is calculated including the Taxable Capital Gain (50% of $400,000) plus the income reported of $28,000 for a total of $228,000.

- Basic Manitoba Income Tax is $2,240.
- Manitoba Net Income Tax is 2% of $228,000.
- Manitoba Surtax is based on the Net Income Tax less a basic credit of $600.

In summary, the total 2000 tax bill to the individual is:

CPP	-	$2,457
Federal Tax (AMT)	-	$31,512
Basic Manitoba Income Tax	-	$2,240
Manitoba Net Income Tax	-	$4,560
Manitoba Surtax	-	$3,960
Total Tax Payable		**$44,729**

(Note: The Manitoba Net Income Tax and Surtax are to be eliminated by 2001 when new provincial tax calculations are implemented. The Federal Surtax is also to be phased out over the next five years.)

What Happens in the Subsequent Years???

The funds from the sale of our example would be invested, resulting in investment income in the following year. A T1 General for 2001 will be filed, along with another T691, which will record the Minimum Tax of $31,512 that was paid in 2000. This can be used to reduce the 2001 federal tax payable by an equal amount, which could possibly bring the federal tax payable to zero. If there was still a residual carryover of the Minimum Tax paid after 2001, this could be carried over into the next year. A continuing AMT carryover can be used to reduce federal tax payable for up to a maximum of seven years after the year the AMT was first paid.

In Conclusion: The Overall Effects of AMT

In this example, the individual pays the AMT and providing that there is reportable income in the next few years will have the federal tax reduced accordingly. The overall effect over these years is as if the taxpayer had not paid the AMT but continued to pay the federal tax as calculated each year.

If the individual had no income for the next few years, however, it could be possible that the AMT amount paid might not be returned. The probability of this occurrence is low, as when AMT is paid there is usually investment income forthcoming in the future.

The AMT calculation can be complex and it is strongly advised that professional services be used when planning tax strategies. The information provided in this Taxation Update is based upon taxation legislation at the date of publication.

For Further Information Contact Your Local Manitoba Agriculture Office.

Prepared By:

Scott Stothers, P.Ag.
Farm Management Specialist

Bob Gwyer, P.Ag.
Farm Management Specialist

Bob McKenzie, P.Ag.
Farm Management Specialist

Terry King, P.Ag.
Farm Management Specialist

Tax Planning Worksheet
ALTERNATIVE MINIMUM TAX EXAMPLE
Based On 2000 Tax Calculation Assumptions

101-02010/

		2000
Income		
Farming Income		35,000
Inventory		
Less: Opt Inventory Adjustment		0
Breeding Stock		
Capital Recapture		0
Capital Gain	400,000	
Taxable Capital Gains	50%	200,000
Total Income		**235,000**
Less: RRSP contributions		7,000
Net Income		**228,000**
Less: Capital Gains Deduction		200,000
Taxable Income		**28,000**
Less: Personal Amounts		
Basic Amount		7,181
CPP Contributions (estimate)		2,457
Total Personal Amounts		**9,638**
Personal Credits @ 17%		1,638
Charitable Donations		
Credit For First $200 @ 17%		0
Credit For Remainder @ 29%		0
Total Non-Refundable Credits		**1,638**
Calculation Of Federal Tax:		
17% On The First $29,797		4,760
25% On The Next $29,797		0
29% On The Remainder		0
Total Federal Tax		**4,760**
Less: Non-Refundable Tax Credits		1,638
Basic Tax (before ATM)		**3,122**
Alternative Minimum Tax Payable		**28,390**
BASIC FEDERAL TAX		**31,512**
New Manitoba 2000 Budget Tax Calculation		
8% on the first $29,950		2,240
12.22% on the next $29,950		0
13.63% on the balance over $59,180		0
2000 Provincial Tax Payable		2,240
Add:Manitoba Net Inc. Tax @ 2%		4,560
Add: Manitoba Surtax		3,960
Less: Manitoba Tax Reduction		0
Provincial Tax Payable		**10,760**
Add: Federal Surtax		0
CPP Contibutions		2,457
Total Tax Payable For Year		**44,729**

Tax Planning Worksheet A
Based On 2000 Tax Calculation Assumptions

			2000
Taxable Income			28,000
ADD: Net Contributions To Plans			
RRSP Deductions			7,000
ADD: Non-Taxable Portion of Capital Gains			
Net Total Capital Gains		400,000	
Net Non-Taxable Part of Capital Gains		50%	200,000
Adjusted Taxable Income			235,000
Less: Basic Exemption			40,000
Net Adjusted Taxable Income			195,000
Federal Tax	@ 17%		33,150
Less: Non-refundable Tax Credits			1,638
Minimum Amount			31,512
Regular Federal Tax Before Surtax			3,122
Alternative Minimum Tax			**28,390**